

Policy No.: MDTA 7010

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Form and Legal Sufficiency Review, Office of Attorney General

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Investment Management

Purpose

The purpose of this Policy is to establish guidelines for the safeguarding and efficient management of the Maryland Transportation Authority's (MDTA) cash and investments. This policy applies to all accounts, including those established under the Trust Agreement.

Reference(s)

- Title 4 of the Transportation Article, Annotated Code of Maryland (as amended)
- Title 6 of the State Finance and Procurement Article, Annotated Code of Maryland (as amended)
- Second Amended and Restated Trust Agreement between the Maryland Transportation Authority and the Bank of New York Mellon (dated as of September 1, 2007, as amended), Section 5.02 Investment of Monies, and applicable provisions of any governing trust agreements (Trust Agreements).
- Governmental Accounting Standards Board (GASB)
- Internal Revenue Code of 1986, Arbitrage Rebate Regulations (as amended)
- Uniform Commercial Code
- MDTA Board Resolution 2011-02 (Authorized Staff)

Scope:

This Policy is applicable to MDTA Finance Staff

Responsible Party:

The Chief Financial Officer (CFO) and Finance Division staff, including the Director of Treasury and Debt, are charged with ensuring compliance and conducting periodic reviews and revisions to this policy.

Investment Management

I. Prudence

- a. **Policy Statement 1.** All investment balances shall be invested with prudence considering the probable safety of the capital as well as the probable income derived.
 - i. Investments and investment practices shall be in compliance with applicable provisions of the Annotated Code of Maryland and to the extent applicable to the MDTA, guidelines established by the State Treasurer and the GASB. Section 6-22 of the State Finance and Procurement Article of the Annotated Code of Maryland does not govern the investment of the MDTA's revenues. This State law applies to political subdivisions, municipal corporations and other specified

governmental entities, but not to agencies or units of the government of the State of Maryland. Section 4-311 of the Transportation Article of the Annotated Code of Maryland gives the MDTA statutory authority to enter into a Trust Agreement and to pledge its revenues. Permitted investments are primarily driven by the definition of Investment Obligations contained in the Second Amended and Restated Trust Agreement dated as of September 7, 2007, with some additional consideration of any other obligations that constitute legal investments for State agencies such as the MDTA.

- ii. The CFO or the Director of Treasury and Debt Management shall report to the Finance Committee any material deviations from this policy.
- iii. The CFO or the Director of Treasury and Debt Management shall immediately report to the Finance Committee any security holding credit rating downgrades initiated by at least two Nationally Recognized Statistical Rating Organizations (NRSROs).

II. Ethics

- a. **Policy Statements 2.** Employees involved in the investment process shall refrain from personal business activity that may create conflicts of interest. Furthermore, employees:
 - i. Are prohibited from undertaking personal investment transactions with the same individual with whom business is conducted on behalf of the MDTA.
 - ii. Must provide annual financial disclosures in accordance with the requirement of the State Ethics Commission, and as otherwise required by law.

III. Delegation of Authority

- a. **Policy Statement 3.** The MDTA's power to manage investment of public MDTA funds is subject to any applicable State and federal law, including Title 4 of the Transportation Article of the Annotated Code of Maryland and Title 6 of the State Finance and Procurement Article of the Annotated Code of Maryland, the MDTA's Master Trust Agreement, Article V, Section 5.02 and applicable provisions of any other MDTA Trust Agreements.
 - i. Responsibility for the operation of the investment program has been delegated by resolution to the CFO and certain Directors of the Finance Division, who shall establish and maintain written administrative procedures and internal controls for the operation of the investment program, consistent with this Investment Policy. Such procedures shall include:
 - 1. Explicit designation of the person(s) responsible for investment transactions.
 - a. No person may engage in an investment transaction except as provided under the terms of this policy and procedures established by the CFO.
 - 2. To the extent not covered by this policy, procedures shall include reference to:
 - a. Safekeeping
 - b. Repurchase Agreements
 - c. Wire Transfer Agreements

- d. Collateral Depository Agreements
- e. Banking Service Agreements
- f. Competitive Bidding Procedures
- g. Cash Flow Requirements

IV. Finance Committee

- a. **Policy Statement 4.** The MDTA's Finance Committee will serve in an advisory capacity to the CFO in its periodic review of the MDTA's Investment Policy, investment strategy, practices and portfolio performance. The Finance Committee is responsible for:
 - i. Reviewing and updating the Investment Policy at least annually.
 - ii. Monitoring the investment transactions to assure that adequate controls are in place.
 - iii. Assuring that the MDTA is in compliance with the Investment Policy.
 - iv. Meeting periodically to deliberate economic outlook, portfolio diversification and maturity structure, cash flow forecasts, potential risks and the interest rate outlook.

V. Allowable Investments

- a. **Policy Statement 5.** Permitted investments include the following instruments:
 - i. U.S. Treasury Obligations - Securities issued or backed by the full faith and credit of the United States Treasury.
 - ii. Federal Agency Obligation- Securities issued by or backed by the full faith and credit of any United States Government agency or government sponsored enterprise with credit ratings in the highest category assigned to that obligor, but in no event less than the double-A category. Includes, but is not limited to:
 - 1. Fannie Mae
 - 2. Freddie Mac
 - 3. Federal Home Loan Bank
 - 4. Federal Farm Credit Bank
 - 5. Federal Intermediate Credit Banks
 - 6. Federal Land Banks
 - 7. Federal Bank of Cooperatives
 - 8. Export-Import Bank of the United States
 - 9. Federal Financing Bank
 - 10. Federal Housing Administration
 - 11. Farmers Home Administration
 - iii. Repurchase Agreements - The MDTA may purchase U.S. Treasury Obligations or Federal Agency Obligations under a repurchase agreement provided that the following conditions are met:
 - 1. The term to maturity of repurchase agreements invested from accounts created by Trust Agreements shall be limited as follows:
 - a. Bond Service Subaccount - 1 year.
 - b. Reserve Subaccount - 1 year.
 - c. Capital Account (bond proceeds) - the expected period of spend out, or five years, whichever is less.
 - d. All Other Funds - 90 days.
 - 2. The contract is fully secured by deliverable U.S. Treasury or

Federal Agency obligations as described in 5i and 5ii above (without limit to maturity), having a market value at all times of a least one hundred two percent (102%) of the amount of the contract.

3. A master repurchase agreement or specific written, repurchase agreement governs the transaction.
4. The securities are held by an independent third-party custodian, acting solely as agent for the MDTA and free of any lien, provided such third party is not the seller under the repurchase agreement.
5. A perfected first security interest under the Uniform Commercial Code, or book entry procedures prescribed at 31 C.F.R. 306.1 et seq. in such securities as created for the benefit the MDTA.
6. For repurchase agreements with terms to maturity of greater than one (1) day, the MDTA will value the collateral securities weekly and require under collateralization to be corrected within one (1) business day.
 - a. If a collateral deficiency is not corrected within this time frame, the collateral securities will be liquidated.
7. The counterparty must meet the following criteria:
 - a. Be a primary government securities dealer that reports daily to the Federal Reserve Bank of New York, or a bank, savings and loan association or diversified securities broker-dealer having \$5 billion in assets or \$500 million in capital and subject to regulation of capital standards by any state or federal regulatory agency.
 - b. Have a minimum long-term credit rating of a least single – A and a short-term rating of not less than Tier-1.
 - c. Have been in operation for a least five (5) years.
- iv. Collateralized Certificates of Deposit- The MDTA may purchase Certificates of Deposit issued by, and time deposits in, any bank or savings and loan association organized under the laws of the State, any other state of the United States or of the United States, including the Trustee; provided that such bank or savings and loan association has combined capital, surplus and undivided profits of a least \$100 million; and provided further that such Certificates of Deposit or time deposits are:
 1. Insured by the Federal Deposit Insurance Corporation.
 2. To the extent not so insured, collateralized by U.S. Treasury Obligations or Federal Agency Obligations, having a market value of a least one hundred two percent (102%) of the amount of contract.
 - a. Securities must be held by the Trustee or an independent third party acting solely as custodian on behalf of the MDTA, free and clear of any lien.
 - b. Maturity for certificates of deposit shall be limited to a maximum maturity of one year.
- v. Banker's Acceptances- The MDTA may purchase Acceptances issued by a domestic bank or a federally chartered domestic office of a foreign bank, which are eligible for purchase by the Federal Reserve System, if the following conditions are met:
 1. The maturity is no greater than two hundred-seventy (270) days.

2. The short-term paper of the issuing bank is rated no lower than Tier-1 by any two (2) NRSROs.
3. The issuing bank has combined net capital of a least \$100 million as indicated in the most recent quarterly financial statement.
4. The amount invested in any single bank will not exceed five percent (5%) of the total funds available for investment (based on book value on the date of acquisition).
- vi. Commercial Paper- Unsecured short-term debt of U.S. corporations may be purchased if the following conditions are met:
 1. Maximum maturity of two hundred seventy (270) days.
 2. Maximum allocation to commercial paper is twenty percent (20%) of the total funds available for investment (based on book value on the date of acquisition).
 3. Maximum allocation to a single issuer is five percent (5%) of the total funds available for investment (based on book value on the date of acquisition).
 4. The issuing corporation, or its guarantor, has a net worth of at least \$50 million.
 5. At time of purchase, the issuing corporation, or its guarantor, has short-term debt ratings of not less than Tier-1 from any two (2) NRSROs and long-term debt ratings of not less than single-A.
- vii. Municipal Securities- The MDTA may purchase obligations of state or local government municipal bond issuers meeting one (1) of the following two (2) conditions:
 1. They are full faith and credit obligations of state or local government municipal bond issuers that are rated at the time of purchase in the highest rating category by at least two (2) NRSROs.
 - a. Downgraded securities that maintain at least one NRSRO rating in one of the top two categories may be held for a reasonable time after the downgrade as necessary to mitigate an investment loss.
 2. Legally defeased municipal obligations that are secured by an escrow containing either U.S. Government Agency Securities or U.S. Government Securities
- viii. Money Market Mutual Funds - The MDTA may purchase shares in open ended investment funds provided such funds are:
 1. Registered under the Investment Company Act of 1940.
 2. Operated in accordance with SEC Rule 2A-7.

Rated in the highest category by at least one (1) NRSRO.
- ix. Maryland Local Government Investment Pool - The MDTA may invest in the Pool with prior permission of the State Treasurer's Office as outlined in Article 95, Section 22G of the Annotated Code of Maryland.
- x. Supranationals - Rated in the highest category by at least one (1) NRSRO and denominated in U.S. dollars, currently limited to:
 1. World Bank - International Bank for Reconstruction and Development (IBRD)
 2. International Finance Corporation (IFC)
 3. Inter-American Development Bank (IADB)
 4. African Development Bank (AFDB)

5. Asian Development Bank (ASIA)
- xi. The CFO may at any time determine in writing that the MDTA temporarily, for a period determined by the CFO, shall not purchase any security or class of securities authorized in this Policy Statement.

VI. Maturity Restrictions

- a. **Policy Statement 6.** MDTA's investment objectives include preservation of principal, liquidity, and longer-term total return performance considerations. The market value of securities in the MDTA's portfolio may fluctuate due to changes in market conditions. MDTA shall manage investments to ensure adequate funds are available when needed.
- i. In addition to the limitations and requirements of applicable provisions of the Annotated Code of Maryland and applicable guidelines established by the State Treasurer and GASB:
 1. Funds shall be invested at all times in keeping with the daily and seasonal pattern of the MDTA's cash balances, as well as any other special factors or needs, in order to assure the availability of liquid funds on a timely basis.
 - ii. Cash flow projections will be monitored and updated on an ongoing basis by MDTA personnel and reported regularly to the investment managers(s).
 - iii. On a periodic basis, a determination will be made, based on cash flow projections and total return performance considerations, regarding the appropriate maturity structures of the portfolios. The final maturity of investments held in each portfolio at the time of settlement may not exceed:
 1. Operating Accounts - 1 Year
 2. Bond Service Accounts - 1 Year
 3. Operating Reserve - 5 Years
 4. Capitalized Interest Accounts - Maturities must precede or coincide with coupon payments dates.
 5. Capital Accounts – 5 Years, or longer if the maturity precedes or coincides with the expected need for funds and only with prior approval of the CFO.
 6. General – 15 Years, or longer with prior approval of the CFO.
 7. Maintenance & Operating Reserve - 15 Years
 8. Debt Services Reserves - 15 Years

VII. Prohibited Securities, Transactions and Activities

- a. **Policy Statement 7.** The following securities, transactions and activities are prohibited:
- i. Reverse repurchase agreements.
 - ii. Short sales (selling a specific security before it has been legally purchased).
 - iii. Borrowing funds for the sole purpose of reinvesting the proceeds of such borrowing.
 - iv. Investing in complex derivatives such as range notes, dual index notes, inverse floating rate notes and leveraged notes, or notes linked to lagging indices or to long-term indices.

- v. Investing in any security for which the investor must be a "qualified institutional buyer" as defined in Rule 144A of the Securities Act of 1933.
- vi. Investing in Mortgage-Backed Securities, Collateralized Mortgage Obligations, Structured Notes, Asset-Backed Obligations, Inverse Floater, and Real Estate Mortgage Conduits (REMICS).
 - 1. As an exception to prohibited asset- and mortgage-backed securities noted in Statement 7.vi, pooled loan securities issued through the Small Business Administration (SBA Pool Securities) and backed by the full faith and credit of the United States are permitted investments.
- vii. Investing in any security not specifically permitted by this Investment Policy.

VIII. Diversification

- a. **Policy Statement 8.** The MDTA will diversify its holdings by security type and institution to avoid incurring unreasonable risks due to excessive concentration in specific instruments, financial institutions or issuers. Diversification standards are as follows:
 - i. Diversification by instrument as maximum percent of the portfolio:
 - 1. U.S. Treasury Obligations - 100%
 - 2. U.S. Federal Agency Obligations -100%
 - 3. Repurchase Agreements - 50%
 - 4. Bankers Acceptances - 20%
 - 5. Municipal Securities - 20%
 - 6. Money Market Mutual Funds -100%
 - 7. Maryland Local Government Investment Pool - 30%
 - 8. Collateralized Certificates of Deposit – 20%
 - 9. Commercial Paper - 20%
 - 10. SBA Pool Securities (Pool/Issue) – 5%
 - 11. Supranationals – 30%
 - ii. Diversification by individual Institution/Issuer/Pool as maximum percent of the portfolio:
 - 1. Repurchase Agreements - 40%
 - 2. Federal Agencies (Issuer) – 35%
 - 3. Commercial Banks (CD) - 5%
 - 4. Money Market Mutual Funds -30%
 - 5. Bankers Acceptances (Institution) – 5%
 - 6. Commercial Paper (Issuer) - 5%
 - 7. Municipal Bond (Issuer) – 5%
 - 8. SBA Pool Securities (Pool/Issue) – 0.5%
 - 9. Supranational – (Issuer) – 10%

IX. Safekeeping, Custody and Additional Requirements

- a. **Policy Statement 9.** All security transactions, including collateral for repurchase agreements, entered into by the MDTA shall be conducted on a deliver-versus-payment (DVP) basis.
 - i. Securities will be held by the MDTA or its designated custodian.
 - 1. If held by a custodian, the securities must be in the MDTA's name or in the custodian's nominee name and identifiable on the

custodian's books as belonging to the MDTA.

- a. If held by a custodian, the custodian must be a third party, not a counterparty (buyer or seller).
 - i. The third-party requirement does not apply to excess checking account funds invested overnight in a bank "sweep" repurchase agreement or similar vehicle.
- b. **Policy Statement 10.** Collateralization is required for Certificates of Deposit and repurchase agreements.
 1. In order to anticipate market changes and provide a level of security for all funds, the collateralization level will be at least one hundred and two percent (102%) of market value of principal and accrued interest.
 2. Collateral will always be held by an independent third party with whom the Authority has a current custodial agreement.
 3. Acceptable collateral is specified under Section 6-202 of the State Finance and Procurement Article of the Annotated Code of Maryland.
 4. The third party trust custodian has the right to reject otherwise acceptable collateral based on their discretion concerning market conditions.

X. Internal Controls

- a. **Policy Statement 11.** The MDTA shall establish a system of internal controls to reasonably prevent loss of public funds as a result of fraud, employee error and/or imprudent action, or misrepresentation by third parties. This system will include:
 - i. An audit of the investment operation shall be part of the annual financial audit conducted by the MDTA or an outside independent audit company.
 - ii. Separation of transaction authority from accounting and record keeping.
 - iii. Avoidance of physical delivery of securities when possible.
 - iv. Clear delegation of responsibility to subordinate staff members.
 - v. Written records of all telephone transactions for investments and wire transfers.
 - vi. Development of a wire transfer agreement with lead bank or third-party custodian, as appropriate.

XI. Authorized Financial Dealers and Institutions

- a. **Policy Statement 12.** The MDTA shall transact securities purchases and sales only with Qualified Institutions or directly with issuers.
 - i. The MDTA shall maintain a list of financial institutions and broker/dealers that are approved for investments purposes ("Qualified Institutions").
 - ii. Direct purchases of securities from issuers are not subject to the Qualified Institutions restrictions.
 - iii. Only firms meeting the following requirements will be eligible to serve as Qualified Institutions:
 1. Primary dealers and regional dealers that qualify under Securities and Exchanges Commission Rule 15C3-1 (uniform net capital rule).

2. Net capital of no less than \$25 million.
 3. Registered as a dealer under the Securities Exchange Act of 1934.
 4. Member of the Financial Industry Regulatory Authority (FINRA).
 5. Registered to sell securities in Maryland.
 6. Engaged in the business of effecting transactions in U.S. government and agency obligations for at least five (5) consecutive years.
- b. **Policy Statement 13.** Qualified Institutions shall be provided with the MDTA's Investment Policy. The MDTA shall maintain on file current audited financial statements for each Qualified Institution with which the MDTA transacts business.

XII. Competitive Selection of Investment Instruments

- a. **Policy Statement 14.** Whenever practical, securities shall be purchased and sold through a formal competitive process requiring the solicitation and evaluation of a least three (3) bids/offers from Qualified Institutions.
- i. Supporting records of the competitive process must be retained including the name of the financial institutions solicited, rate quoted, description of the security, investment selected, and any special considerations that had an impact on the decision.
 - ii. If the highest yielding security was not selected for purchase or if three bids/offers from Qualified Institutions are not obtained, an explanation describing the rationale will be included in this record.

XIII. Investment of Bond Proceeds

- a. **Policy Statement 15.** The MDTA shall comply with all applicable sections of the Internal Revenue Code of 1986, Arbitrage Rebate Regulations (as amended) and bond trust covenants with regard to the investment of bond proceeds. The MDTA will consult with bond counsel to ensure that non-compliance is remediated in accordance with income tax regulations. Accounting records shall be maintained in a form and for a period of time sufficient to document compliance with these regulations and covenants.

XIV. Reporting

- a. **Policy Statement 16.** MDTA staff shall provide the CFO with a monthly statement of transactions and holdings priced at market. At least quarterly, a report must be prepared detailing compliance with policy constraints. The report may include, but is not limited to the following:
- i. Portfolio performance versus benchmarks, analyzed on a total return basis for those funds invested pursuant to a strategy that may result in the sale of securities that are not intended to be held until maturity.
 - ii. Percentage of total portfolio by investment class and comparison to diversification limits in Policy Statement 8.
 - iii. Holding by institution/issuer/pool and comparison to diversification limits in Policy Statement 8.
 - iv. An investment plan for the next quarter-describing the target maturity structure, duration, and asset allocation.

XV. Definitions

- a. For the purposes of this Policy, the following words have the following meanings:
 - i. NRSRO - Nationally Recognized Statistical Rating Organization or rating agency (e.g., Moody's, S&P, Fitch).

XVI. Authorized/Supporting Documents

- a. None

XVII. Policy History

- a. Approved 8.16.05
- b. Approved 8.10.06
- c. Approved 9.20.07
- d. Approved 12.13.07
- e. Approved 3.26.08
- f. Approved 6.12.08
- g. Approved 9.23.09
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- t. Approved 12.19.19
- u. Approved 2.27.20